19.01 Partnership Operations

Accounting for Partnerships

Accounting for partnerships **differs from corporations** in two significant ways:

- A partnership isn't a taxable entity (Form 1065), so no provisions are needed for current or deferred income taxes.
- The equity section does not distinguish between contributed capital and retained earnings, but instead simply identifies the capital balances of each partner.

Formation

- Assets are valued at fair value
- Liabilities assumed are recorded at their present value
- If noncash (land or equipment) contributions subject to a mortgage are made, the contributing partner's capital account is credited for the fair value of the noncash asset less the mortgage assumed by the partnership.
- Partner's capital account equals the difference between the fair value of the contributed assets less the present value of liabilities assumed.

The **allocation of equity (Operation of P/S)** represents virtually most of the testing on a typical CPA exam. Partners are credited for contributions and debited for distributions directly. Income is allocated in three steps:

1. Partners may be **allocated interest** on the average capital balances they maintained during the year.
2. One or more partners may be allocated a **fixed salary** for services rendered to the partnership.
3. The **remaining income** or loss is allocated based on the partnership agreement or, in the absence of agreement, equally (unless capital is the main income producer, as in the case of an investment partnership, in which case income is normally allocated based on capital balances).

For example, assume that Abe, Bea, and Cy are equal partners in the ABC Partnership, and maintained average capital balances during 20X1 of $50, $80, and $20, respectively. To encourage the partners to leave capital in the business, each partner is paid 10% on the capital balances they maintain. Bea runs the store and is provided a $20 salary on top of profits. If partnership income during 20X1 totaled $71, the allocation would be as follows:

Partner	Abe	Bea	Cy	To Allocate
Average capital	50	80	20	
Income				71
10% interest	5	8	2	–15
Subtotal				56
Salary		20		–20
Subtotal				36
Profit sharing	12	12	12	–36
Allocation	17	40	14	--